THE GLOBE AND MAIL

No U.S.-style housing crash for Canada: report

TARA PERKINS - REAL ESTATE REPORTER
The Globe and Mail
Published Tuesday, Oct. 30 2012, 8:11 AM EDT
Last updated Tuesday, Oct. 30 2012, 10:54 AM EDT

While many concerns stem from the Canadian housing market, it will not see an American-style crash, a new Canadian Imperial Bank of Commerce report says.

House prices will likely fall north of the border in the next year or two, but a number of factors are likely to mitigate the impact on borrowers and the broader economy here, it suggests. It forecasts that the Canadian market will likely go through a soft landing, which is exactly what policy makers in Ottawa are hoping.

Factors that should cushion the damage that lower house prices could cause include a lower degree of speculation in the Canadian market, and higher quality mortgages, the report says.

The Canadian debt-to-income ratio in Canada recently rose above the level that it had been at in the U.S. prior to that country's housing crash, a development that raised some alarm bells for a number of economists.

But CIBC deputy chief economist Benjamin Tal says in this report that less attention should be paid to the level the debt-to-income ratio has hit, and more to the speed at which it has been rising. A number of other countries have had higher ratios without a crash, he suggests. And in the last three years the ratio in Canada has been rising at half the speed that it did in the pre-crash U.S. market, making it appear less threatening, he says.

He also stresses that the quality of mortgages in Canada, as determined in large part by the credit scores of borrowers, is much better.

One-third of mortgages taken out in the U.S. in 2005 and 2006 were in negative equity positions before house prices dropped, and at least half of the mortgages had less than five per cent equity, making them extremely vulnerable to even a small drop in prices, Mr. Tal says. In Canada, only 15 to 20 per cent of new mortgages have less than 15 per cent equity, and the negative equity position is nil, he says.

In addition, Canadian borrowers have begun reducing their exposure to rising interest rates by choosing fixed-rate mortgages over variable. The opposite occurred in the U.S. where adjustable rate mortgages remained popular until the bitter end, the report says.

It also pokes holes in some of the reasons that policy-makers and bankers in Canada often cite for keeping the Canadian housing market on a solid footing. For instance, bankers will regularly point to the extremely low mortgage delinquency rate here. “But as the U.S. experience teaches us, this sea of tranquillity can turn into a violent storm overnight,” Mr. Tal writes. “In a short eighteen-month period in 2007-08, the serious mortgage arrears rate in the U.S. surged by more than 300 per cent.”

Canadians also draw false comfort from the idea that lenders in all provinces but Alberta have recourse on mortgages, meaning they can go after a borrowers’ other assets to pay off a mortgage. The reality is that only twelve U.S. states are non-recourse, Mr. Tal writes. And there actually appears to be no significant difference in housing market performance between recourse and non-recourse states.

But there are plenty of other factors that should help Canadians sleep a little bit better at night, the report suggests.

“When it comes to jitters regarding a U.S.-type meltdown here at home, the only thing we have to fear is fear itself,” it says.